

VERMONT STATE TEACHERS' RETIREMENT SYSTEM

Meeting of the Board of Trustees

August 18, 2004

Board Members present:

JOSEPH MACKEY, Chairperson (Active No. 29334), term expiring July 1, 2005

JON HARRIS, Vice-Chairperson (Active No. 25669), term expiring July 1, 2007

JAY KAPLAN, Association of Retired Teachers of Vermont, term expiring July 1, 2008

THOMAS CANDON, representing Commissioner of BISHCA

VAUGHN ALTEMUS, representing Commissioner of Education

JEB SPAULDING, VT State Treasurer

Also attending:

Cynthia Webster, Director of Retirement Operations

David Minot, Director of Investment Services

Elizabeth Pearce, Deputy Vermont State Treasurer

Donna Holden, Board Coordinator

Dick Charlton, Ellen Griggs, Kevin Kondry, NEPC

David Driscoll, Mellon Consultants

William Griffin, Chief Assistant Attorney General

Mike McShane, Assistant Attorney General

David Beatty, Budget Analyst, Finance and Management

Rita Rinehart, Association of Retired Teachers of Vermont

Angelo Dorta, VT-NEA

Investment Manager personnel

The Chairperson, Joe Mackey, called the meeting to order at 8:05 a.m. on Wednesday, August 18, 2004, in the Ethan Allen Conference Room at the Vermont State House, Montpelier, Vermont.

ITEM 1: Election of Officers

The Chairperson opened the floor for nominations for the position of Chairperson.

Mr. Kaplan nominated Joe Mackey, seconded by Mr. Altemus.

Hearing no other nominations, Mr. Kaplan moved to closed nominations, seconded by Mr. Harris.

The Board unanimously voted to elect Mr. Mackey as Chairperson.

The Chairperson opened the floor for nominations for the position of Vice-Chairperson.

Mr. Candon nominated Mr. Harris, seconded by Mr. Altemus.

Hearing no other nominations, Mr. Kaplan moved to closed nominations, seconded by Mr. Altemus.

The Board unanimously voted to elect Mr. Harris as Vice-Chairperson.

The Chairperson opened the floor for nominations for the position of Secretary.

Mr. Altemus nominated Cynthia Webster, seconded by Mr. Harris.

Upon review of 16 V.S.A § 1942(g), which indicates this position is appointed, not elected, Mr. Altemus withdrew his nomination.

Mr. Mackey advised the Board of the death of John Goss, a long time (28 years) Board Trustee and past Chairperson. He asked for a moment of silence to allow members to reflect on the life of Mr. Goss and his service to the Vermont State Teachers' Retirement System.

ITEM 2: Investment Consultant Report for Q2/04

Mr. Charlton, Ms. Griggs and Mr. Kondry reviewed the second quarter 2004 performance. They reported the market value of the fund balance at approximately \$1.238 billion and a quarterly return of .02%, an out performance of the (0.2%) median public fund. The one-year return was 15.7% vs. the median public fund at 14.6%, three-year return 5.2% vs. the median public fund at 4.4% and a five-year return of 4.5% vs. 4.1%.

The Board requested Mr. Minot provide verification of the Board's SPIF/STIF investment policy. And if there is not currently a policy, Mr. Minot was asked to develop a policy for the Board's approval.

ITEM 3: Investment manager Presentations

Wellington Management Co. – Small Cap Value: Stephen O'Brien, Portfolio Manager and Alexander Grant, Relationship Manager, appeared before the Board. The Small Cap Value portfolio market value reported was approximately \$79.2 million as of June 30, 2004 with a Q2/04 return of 1.2% vs. 0.8% for the Russell 2000 Value Index. The manager's inception date was September 2003, therefore, one, three and five-year performance were not available.

PruTimber – Real Estate: John Lord, Managing Director, appeared before the Board. PruTimber reported assets of \$120 million under management in their closed-end, commingled real estate portfolio, of which the VSTRS quarterly balance was approximately \$6.5 million of the fund. The return for the quarter ending June 30, 2004, was reported at .29%; one-year performance was 3.79%; three-year performance was .51% and five-year performance was 1.83%.

ITEM 4: Director of Finance & Investments Report

Mr. Minot reported \$22 million was successfully moved from the SSR Tower Fund to the Morgan Stanley Prime Property Fund. The remaining 5% of the fund liquidation will be transferred in the near future.

Mr. Minot also reported the recently implemented commission recapture programs has not been widely successful; therefore he will be working with State Street Bank to encourage managers, when able, to participate in the program.

Mr. Minot was asked to prepare a report that explains the securities lending amounts, and why the VSERS earns more.

ITEM 5: Approval of the Minutes of June 14, 2004

On a motion by Mr. Kaplan seconded by Mr. Altemus, the Board unanimously voted to approve the minutes of June 14, 2004 as submitted.

ITEM 6: Ratify the Disability Retirement for: *Theodore J. Mader*

On a motion by Mr. Kaplan seconded by Mr. Candon, the Board unanimously voted to approve the disability retirement for Theodore J. Mader, as recommended by the Medical Review Board.

ITEM 7: Travel Request to NCTR

Mr. Altemus requested permission to attend the annual NCTR conference.

On a motion by Mr. Mackey seconded by Mr. Kaplan, the Board unanimously voted to grant permission to Vaughn Altemus to attend the annual NCTR conference in Portland, Oregon October 9-14, 2004.

ITEM 8: Discuss/Act on Large Cap Investing Alternatives

The Board discussed NEPC's August 17, 2004 Domestic Large Cap Review recommendation of:

•Step One:

–Partially fund equally between Enhanced S&P 500 product and a Equal Weighted S&P 500 product within each System

• Recommend search for Enhanced Index manager

• Recommend SSGA for Equal Weighted Index

–Choose and fund manager for Enhanced S&P 500 portfolio

–Fund manager for Equal Weighted S&P 500 portfolio

–Restructure the centrist approach to the large cap portfolio at a lower fee base

–Potential savings across all three Plans will be approximately \$1.8 million

•Step Two: Satellite Considerations

–On the margin, free up time to allow more focus on value added activities (alternative manager selection, traditional and non-traditional high alpha strategies and hedge funds)

On a motion by Mr. Candon seconded by Mr. Altemus, the Board unanimously voted to authorize NEPC to initiate two RFP searches, the first for an Equal Weighted S&P 500 Index manager, the second for an Enhanced, Cap Weighted, S&P 500 Index manager which would also include a request for respondents to provide information regarding a standard S&P Cap Weighted product.

ITEM 9: Discuss Under Funding: Board Roll, Actuarial Implications

David Driscoll of Mellon Consultants appeared before the Board. Mr. Driscoll was asked to address two points of major concern to the Board regarding the impact to the system as a result of:

- The years of sustained and potentially continued under funding of the system, and
- The impact to the system as a result of GASB 43 & 45

Mr. Driscoll shared a forecast indicating that, if future state contributions continued at the rate of \$21 million per year and benefits and expenses emerged in accordance with current expectations, the VSTRS would be totally insolvent by year 2029. Under a second forecast, which illustrated the effect of continued state contributions at a rate of approximately 5% of expected future payroll, the insolvency of the System would be expected to occur in the year 2036. Graph 1 Graph 2

Mr. Charlton pointed out that current annual outlay for plan expenses is approximately 3% while the system's target rate of return is 8%, representing a net 5% estimated earnings to invest for future liabilities. In the event of sustained lack of returns, and without the full state appropriation, it would take a very short time to begin a de-capitalization of the system.

Added pressure on the system, effective FY'07, will result from mandatory accounting for other post-employment benefits (i.e., retiree health care benefits) under two new GASB standards, no. 43 and no. 45, which will require the reporting of expense and liabilities for such benefits. The reported financial position of the system will deteriorate as a result of the application of these standards, given the present practice of funding the system's expenses (including retiree health care expenses) as an offset to the system's expected 8% rate of return and the large year-to-year increases that are projected for health care premiums.

The Board requested Mr. Driscoll provide an estimate of what the cost would be to calculate a projection of cost obligations as required by GASB, effective FY'07. Ms. Webster will advise the Board prior to authorization.

The Board agreed to meet with Mr. Driscoll on October 25, 2004 to review the valuation and other materials.

ITEM 10: Treasurer's Report

➤ Maximus Report Review

Beth Pearce, Deputy State Treasurer reported on the successful changes and re-organization in the Retirement Office as a result of the Maximus study recommendations.

➤ Expenses

Ms. Pearce provided the Board with at review of the Board's 12/16/03 action to approve the FY'05 base budget, specifically the expenses of the Retirement re-engineering project. Also provided was information regarding a comparison of similar re-engineering implementations including costs and results.

Ms. Pearce was requested to research whether there were any other way alternatives, i.e. outsourcing, system sharing, etc. to provide a retirement system without the VSTRS having to spend the amount of money requested over the next few years.

Ms. Rinehart suggested seeking a grant for payment assistant.

ITEM 11: Director of Retirement Operations Report

➤ Bernie FitzGerald

Ms. Webster advised the Board that in 1993 this member elected a level income option at the time of

his retirement. Since that time the retiree has returned to work and membership in the system twice, resulting in two subsequent accrued benefits that were added to the first. The retiree has been collecting his combined benefit for approximately two-years.

Mr. FitzGerald is now claiming that he was misinformed at the time of his first election regarding the level income benefit reduction at age 62.

The Board requested the Attorney General's Office consult with Ms. Webster and present a recommendation to the Board at their November meeting.

➤ AG's Opinion re: Disability Retirements

Ms. Webster advised the Board Mr. McShane, Assistant Attorney General, provided an opinion regarding whether action on the Medical Review Board's disability retirement recommendations could be assigned rather than the Board having to review confidential, medical information.

The Board agreed in the future to receive only the ballots and certification for action. Mr. Spaulding will review the file, medical information, and Medical Review Board's fact-finding. Mr. Spaulding would in turn alert the Board of any concerns he felt the Board should act upon.

➤ Reporting Professional Leave Compensation

The Board reviewed their previously agreed upon policy that compensation received "under contract" for any compensation, directly related to the benefit of students, should be included in the wages reported.

The Board requested Ms. Webster prepare a summary of the current issue, and recommendation for the Board's action at the November meeting.

Ms. Webster advised she would also be preparing information for the next meeting regarding two issues; the development of a policy and adoption of a methodology for service credit calculations, and recommendation for a review and change in management of the SDIA program.

ITEM 12: Any other business to come before the Board

None

Next Meeting Dates:

The next quarterly investment meeting is scheduled for November 17, 2004.

On a motion by Mr. Harris seconded by Mr. Candon, the Board unanimously voted to adjourn at 5:15 p.m.

Respectfully submitted,

Cynthia Webster, Secretary to the Board